

[*249] Appeal from a decision of the Colorado State Office disallowing the termination of the period of liability for an oil and gas lease bond. KS W-41016(Acq.)

Affirmed.

1. Oil and Gas Leases: Bonds -- Oil and Gas leases: Compensatory Royalty

The period of liability of an oil and gas lease bond may not be terminated until all the terms and conditions of the lease have been satisfied, including the payment of all necessary compensatory royalty.

APPEARANCES: R. K. Teichgraeber, pro se.

OPINION BY ADMINISTRATIVE JUDGE KELLY

R. K. Teichgraeber has appealed from a decision dated May 28, 1985, by the Colorado State Office, Bureau of Land Management (BLM), disallowing the termination of liability on oil and gas lease bond 87-0130-11068-83-8, in the amount of \$10,000 by United States Fidelity and Guaranty Company (Surety) of Wichita, Kansas.

The bond was executed on December 1, 1983 (Form 3104-1 (August 1973)), and approved December 6, 1983. The bond covers lease KS-W 41016 embracing 230.47 acres in T. 20 S., R. 14 E., sixth principal meridian, Coffey County, Kansas. The lease issued effective February 1, 1974, and was assigned to appellant effective August 1, 1974.

By letter dated January 19, 1978, appellant was requested by an official of the Tulsa Area BLM office to advise BLM of his plans to protect the lease from possible drainage by appellant's offsetting well No. 1 Newkirk and Westrans Petroleum No. 2 Metzler located in the vicinity of the lease.

Having received no response, BLM's Deputy Minerals Manager for Oil and Gas Resources, by letter of April 1, 1983, informed appellant that compensatory royalty for drainage from lease KS W-41016 would be assessed effective December 1977, the date of first production from the Newkirk No. 1 well. The letter stated a formula according to which compensatory royalty would be calculated but imposed no actual monetary assessment.

On January 25, 1984, the Minerals Management Service (MMS), 1/ billed appellant in the amount of \$13,355.95 for compensatory royalty for oil drained from the lease based on the calculation announced in the April 1, 1983, letter. Appellant received the bill on January 31, 1984 (Statement of Reasons, Encl. 3-1), but was not advised of his right of appeal. On February 14, appellant contacted MMS and was advised to file his appeal with that agency. In a February 23, 1984, statement of reasons, appellant challenged the assessment of compensatory royalty, asserting it had intended to drill a well on the lease in April 1983 and had a location staked for the drill site; further operations were suspended after an onsite inspection performed by a Mr. Gillingham of BLM and a Mr. Bane of Teichgraeber Oil revealed that the location staked was not on Federal land but on private (Newkirk) property 2/ ; and lease KS W-41016 had since expired and appellant would probably not take any action to reacquire it. Appellant also pointed out that while the compensatory royalty assessment is based on an assumed well spacing/drainage area of 40 acres, in Kansas the State allocation for producing wells in the lease area is in fact 2.5 acres (drainage radius 165 ft.). Accordingly, appellant argued that drainage should be defined by the 2.5-acre limitation and that no drainage had occurred from the 40-acre area claimed by BLM. Appellant further argued that BLM had failed to properly substantiate its assessment by providing evidence of drainage, and that the boundary uncertainty as between private and Federal lands had not been resolved.

By letter of March 12, 1984, MMS forwarded the appeal to the Colorado State Office. The letter acknowledged "that one of the main areas for resolution involves a determination as to whether drainage did in fact occur due to the well spacing regulations unique to the State of Kansas."

By letter dated August 20, 1984, BLM's Deputy State Director for Mineral Resources responded to MMS. He referred to his April 1, 1983, letter as a "decision" which was not timely appealed and therefore final, as appellant's statement of reasons was dated February 23, 1984. The Deputy State Director considered that portion of the appeal challenging the January 25, 1984, royalty bill as timely filed, and referred it back to MMS for proper handling.

1/ The responsibility for regulating onshore oil and gas operations and collecting royalties on Federal and Indian oil and gas leases rested with the Conservation Division, Geological Survey, U.S. Department of the Interior, until February 1982, when these responsibilities were transferred to MMS by Secretarial Order No. 3071, 47 FR 4751 (1982). Subsequently, by Secretarial Order No. 3087 and Amendment No. 1 thereto, dated Dec. 3, 1982, and Feb. 7, 1983, respectively, 48 FR 8983 (1983), all onshore minerals management functions of MMS not relating to royalty collection were transferred to BLM. The latter order specifically transferred inspection and enforcement authority over onshore minerals on Federal and Indian lands to BLM.

2/ We note the file contains no BLM document addressing a problem in the location of appellant's proposed drill site.

By letter dated April 11, 1985, the Surety suggested to BLM's Grand Junction, Colorado, District Office that the bond was not needed and that its release date was April 30, 1985. A May 1, 1985, handwritten note from the Canon City District Office, BLM, to the Chief, Mineral Leasing Section, states as follows:

I am sending the notice regarding release of R. K. Teichgraeber oil and gas bond as we discussed this morning.

We are not sure what the subject bond covers as Mr. Teichgraeber has 3 or more leases and we have a file containing an APD on another lease.

Since Mr. Teichgraeber paid the compensatory royalty under protest we consider the lease held by production at least for the present time.

The bonding company needs to be reminded of the proper office for filing these notices as it was sent to GJDO instead of CSO. They also apparently need to be informed that only CSO can release a bond.

We recommend the bond be continued until the drainage situation is settled if you feel this is appropriate. We are not even sure it covers the subject lease W-41016.

On May 28, 1985, BLM issued its decision disallowing termination of liability on the bond, stating that by the terms of the bond no automatic release of liability was possible. The decision further stated:

Once a bond has been accepted, it can be released, cancelled or terminated only pursuant to its own terms. The United States, acting through the Bureau of Land Management (BLM) will not release, terminate or permit the cancellation of the bond until all obligations have been fulfilled or a satisfactory replacement bond has been accepted.

Our Canon City District Office considers this lease to be held by production and recommends bonding be continued until the drainage situation is settled. The principal has appealed the requirement to pay compensatory royalty for the drainage which is occurring on this lease.

Appellant appealed BLM's decision, filing its statement of reasons with the Board on July 1, 1985. In its statement, appellant restated and summarized its February 23, 1984, statement of reasons and attached a copy thereof.

[1] The issue before the Board is whether consent to termination of liability on the bond was properly withheld. Regulation 43 CFR 3104.8 provides:

The authorized officer shall not give consent to termination of the period of liability of any bond unless an acceptable

alternative bond has been filed or until all the terms and contions of the lease have been met. [Emphasis added.]

The bond at issue provides in part that it shall remain in full force and effect, notwithstanding:

3. Any extension of the lease term, any modification of the lease, or obligations thereunder, whether made or effected by commitment of the lease to any unit, cooperative, communitization or storage agreement, or development contract, suspension of operations or production, waiver, suspension or change in rental, minimum royalty and royalties, compensatory royalty payments, or otherwise. [Emphasis added.]

Section 2(c)(1) of appellant's lease requires the lessee "[t]o drill and produce all wells necessary to protect the leased land from drainage by wells on lands not the property of the lessor" and in the absence of such drilling and production, to "compensate the lessor in full each month for the estimated loss of royalty through drainage." See also 43 CFR 3162.2(a).

The record indicates appellant paid the assessment of compensatory royalty under protest and appealed the assessment, which was referred to MMS for resolution. Based upon the above-cited conditions of appellant's bond and lease, it is clear that 43 CFR 3104.8 prohibits BLM from allowing termination of the bond until the assessment of compensatory royalty issue has been resolved. An oil and gas lease bond may not have its period of liability terminated until all the terms and conditions of the lease have been satisfied. O. R. Weyrich, Jr., 49 IBLA 347 (1980). We therefore conclude BLM properly disallowed termination of the period of liability under the bond.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

John H. Kelly
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge

ADMINISTRATIVE JUDGE BURSKI CONCURRING:

This appeal involves solely the question whether or not the performance bond for acquired lands lease W 41016 (KS) should be released. I would submit, however, that this question is inextricably intertwined with issues which had been appealed to the Director, MMS, (docketed as MMS-84-0067-O&G) and which complicate considerably resolution of this appeal.

The majority sets forth in detail the factual construct in which this appeal arises. I wish to concentrate on one specific area of contention. Appellant has been assessed compensatory royalty for the failure to drill a well to protect the leased premises from drainage allegedly occurring from an offset well. Appellant has paid this royalty under protest and has appealed the assessment. Thus, it would seem to me that, if this compensatory royalty assessment established the limits of appellant's liability for drainage, there would be no justification for requiring maintenance of the bond since the money appellant has already tendered would protect the Government's royalty interests. The question, then, is whether the MMS assessment of January 25, 1984, did indeed cover all of appellant's possible liability.

Appellant argues on appeal that the lease expired upon the completion of the original term, i.e., midnight on January 31, 1984. BLM, on the otherhand, apparently contends that the lease continues in existence beyond its original term because of the payment by appellant, albeit under protest, of compensatory royalty, which payment served to extend the lease. This is a critical point since, if the lease is still in esse, further assessments of compensatory royalty are likely and BLM could not, consistent with 43 CFR 3104.8, release the bond until all outstanding debts were paid in full.

The applicable statute, 43 U.S.C. § 226(g) (1982), provides:

Whenever it appears to the Secretary that lands owned by the United States are being drained of oil or gas by wells drilled on adjacent lands, he may negotiate agreements whereby the United States, or the United States and its lessees, shall be compensated for such drainage. Such agreements shall be made with the consent of the lessees, if any, affected thereby. If such agreement is entered into, the primary term of any lease for which compensatory royalty is being paid, or any extension of such primary term, shall be extended for the period during which such compensatory royalty is paid and for a period of one year from discontinuance of such payment and so long thereafter as oil or gas is produced in paying quantities. [Emphasis supplied.]

Two relevant points can be made. First, the statute clearly requires the consent of the lessee to any compensatory royalty agreement. ^{1/} Second,

^{1/} We noted in Bruce Anderson, 80 IBLA 286, 91 I.D. 203 (1984), that while the statute, by its terms, relates to agreements between the owner of the offending well and the United States, with the Federal lessee as merely an

where a compensatory royalty agreement has been entered into, the lease will be extended beyond its expiration date for the period that compensatory royalty is paid and for 1 year after discontinuance of such payments and so long thereafter as oil or gas is produced in paying quantities.

The extension of the primary term of the lease, of course, is designed to and normally does benefit the lessee. In this case, however, if the primary term is extended the lessee may actually suffer a detriment since, so long as lease W 41016 (KS) (Acq.) continues, liability for compensatory royalty would continue to accrue, assuming a continuation of production from the offending well. And, if further liability has, in fact, attached to the lease, the majority correctly refuses to terminate the bond.

I have grave doubts whether payment of compensatory royalty under protest manifests an agreement of the lessee within the meaning of 30 U.S.C. § 226(g) (1982). We have noted that where drainage is occurring 2/ and a lessee is directed to drill a well to protect Federal lands against such drainage, the lessee actually has three options. He can drill the well (or where drilling is not feasible, submit a communitization agreement), he can pay compensatory royalty, or he can surrender the lease. See Bruce Anderson, 80 IBLA 286, 299-300, 91 I.D. 203, 210 (1984). Thus, inasmuch as a lessee may surrender a lease rather than agree to the assessment of compensatory royalty, it would seem to me that payment of accrued compensatory royalty under protest is inconsistent with the view that the lessee has agreed to the extension of his lease.

However, while a lessee has a right to surrender the lease rather than tender compensatory royalty, such action must be taken within a reasonable time from the notification that he must drill an offset well or submit compensatory royalty. In the instant case, so far as the present record discloses, appellant never, by any affirmative action, relinquished the lease. Assessments for compensatory royalty properly accrued "after the passage of a reasonable time following notification of the offending well." Id. at 301, 91 I.D. at 211. They would continue to accrue so long as the lease, itself, continued. A relinquishment of the lease made after this period could only be allowed upon the payment of the compensatory royalties which had accrued. 3/ Similarly, while the lease may expire, the

fn. 1 (continued)

interested party, the compensatory royalty payments are made the obligation of the Federal lessee pursuant to 30 CFR 221.21 (1982) (now 43 CFR 3162.2(a)), as part of the lessee's express obligation to protect the United States from drainage under section 2(c)(1) of the standard lease form. Id. at 299, 91 I.D. at 210.

2/ A lessee may, by timely appealing an order of MMS, attempt to show either that drainage is not occurring or that, under the prudent operator rule, the drilling of an offset well is not required. See generally Nola Grace Ptasynski, 63 IBLA 240, 89 I.D. 208 (1982).

3/ While 30 U.S.C. § 187b (1982) provides that a written relinquishment is effective as of the date of its filing, it makes such a relinquishment "subject to the continued obligation of the lessee and his surety to make payment of all accrued rentals and royalties."

obligation to pay royalties to the date of lease expiration prevents release of the bond until the assessments are tendered. In the instant case, the January 25, 1984, assessment covered only the period from January 1978 through May 1983. Thus, it would seem that no compensatory royalties were tendered for the period from June 1983 through January 31, 1984, when the lease would expire at midnight. There would therefor seem to be possible accrued royalties which are not covered by the payment under protest. Given the present posture of this case where many of the substantive issues are not yet before the Board, I must agree that we cannot authorize release of the bond. ^{4/} For the above reasons, which I believe to be implicit in the majority's conclusions, I concur in the denial of the appeal.

James L. Burski
Administrative Judge.

^{4/} I am aware that, by decision of Dec. 23, 1986, the Director, MMS, remanded the matter to the Royalty Mangement Program for a recomputation of the amount of royalty due. This decision, however, is apparently not final and does not address a number of the other substantive issues involved in the case.

